# DEPARTMENT OF FINANCE BILL ANALYSIS

**AMENDMENT DATE:** 05/25/2012
**POSITION:** Oppose

**BILL NUMBER:** SB 1243
**AUTHOR:** Lowenthal, Alan

**BILL SUMMARY: Sales and use taxes: exemptions: marine or maritime fuel.**

This bill would extend the sunset date of January 1, 2014 to January 1, 2024 for the sales and use tax (SUT) exemption for fuel and petroleum products sold to water common carriers.

## FISCAL SUMMARY

The Board of Equalization (BOE) estimates that extending the SUT exemption sunset date would result in annual General Fund revenue losses in the range of $40 million to $60 million. This estimate appears to slightly understate the revenue impact of extending the exemption by an estimated $20 million.

According to the BOE, since the department currently administers the program, minor costs to educate taxpayers of the extended sunset date would be absorbable.

## COMMENTS

**The Department of Finance opposes this bill.** Although the sunset of the partial SUT fuel exemption could negatively impact the maritime fuel industry in California, extending the sunset date would negatively impact state SUT revenues during challenging economic times.

## ANALYSIS

1. Programmatic Analysis

   **Under existing law**, the SUT applies to all charges related to the sale of tangible personal property, with some exemptions. Currently, the sale of fuel and petroleum products sold to a water common carrier, for immediate shipment outside this state, are exempt from tax when used in the conduct of the purchaser's common carrier activities after the first out-of-state destination. The exemption requires a water common carrier to only pay tax on the fuel needed to get from California to its first out-of-state destination. This exemption is commonly referred to as the bunker fuel exemption.

   During the early 1990's this SUT exemption was temporarily repealed and then reinstated with a five year sunset date. In 1997, the 1998 sunset date was extended an additional five years to 2003 and required the Legislative Analyst Office (LAO) to publish a study on the impact of the SUT exemption. In that study, the LAO recommended permanent removal of the exemption's sunset date. The Legislature unsuccessfully attempted to extend the 2003 sunset date. Thus, bunker fuel sales were taxed for about one year, before the exemption was reinstated.

   The exemption is scheduled to sunset January 2014.

   **This bill,** as introduced, would have made the exemption permanent. The latest version, proposes to extend the sunset date by ten years to January 1, 2024. This bill also replaces the term "bunkered"

**ANALYSIS** (continued)

with "transferred" to update outdated terminology. According to the BOE, who had conversations with industry experts, the reference change to replace outdated terminology is not anticipated to increase the amount of fuel that would be exempt.

The exemption is in line with common application of a use tax; it is applied to purchases of goods consumed in the state. The bunker fuel exemption appropriately assesses the SUT on only the fuel used from a California port to the first out of state destination. Removing this tax exemption will increase the cost to do business and could potentially impact employment however, the net impact to California's economy is unknown.

Over the last 20 years, the partial exemption has been repealed and reinstated. Supporters of the bill highlight that a long-term partial SUT exemption would help provide certainty within the maritime fuel industry. Such long term policies can help spur long-term investment planning. Additionally, the Legislative Analysts' Office researched the effectiveness of this exemption and found that the repeal of this exemption had a significant negative effect on California bunker fuel sales and jobs. Specifically, they reviewed both times the exemption was repealed (in the early 1990's and 2003) and found that the SUT exemption repeal likely resulted in the loss of 100 to 200 jobs and increased SUT revenue in the tens of millions of dollars. This analysis was the basis for LAO's recommendation to eliminate the sunset date associated with this tax exemption.

2. Fiscal Analysis

The BOE estimates that extending the exemption beyond 2013 would result in annual revenue losses in the range of $90 million to $130 million. Based on reports published by the United States Energy Information Administration, price data published by Pacific Merchant Shipping Association (PMSA) and a study conducted by Price Waterhouse for PMSA, maritime fuel exempt from the use tax for fiscal year 2010-11 is estimated to total $2,619 million in sales.

Comparing 2010 sales data to 2011 sales data supports a trend of declining maritime fuel sales. Therefore, for 2014, BOE estimates maritime fuel sales that would qualify for the exemption to be 40 percent to 60 percent of estimated sales for fiscal year 2010-11. Based on examining a longer series of sales data, the Department of Finance estimates that 2014 sales could decline but not at such a high rate. A 20 percent decline (relative to fiscal year 2010-11) appears to be reasonable. This results in estimated maritime fuel sales of $2,095 million ($2,619 million sales x 80 percent). Applying a tax rate of 8.75 percent to estimated sales results in annual losses of $180 million. The annual impact to the General Fund represents about 45 percent, or about $80 million.

It should be noted that the estimate assumes that the definitional change does not increase the amount of fuel that could qualify for the exemption. According to BOE, their estimate was developed based on the author's intent to update outdated terminology. It is unknown what additional losses would be realized if the definitional change does impact the amount of fuel that would qualify for the exemption.

**BILL ANALYSIS--(CONTINUED)** **Form DF-43**

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| Code/Department Agency or Revenue Type | SO LA CO RV | PROP 98 | FC | (Fiscal Impact by Fiscal Year) (Dollars in Thousands) 2012-2013 | FC | 2013-2014 | FC | 2014-2015 | Fund Code |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 1149/Sale Use Tax | RV | Yes | | ----- See Fiscal Analysis ----- | | | | | 0001 |
| 0860/Equalization | SO | No | | ----- No/Minor Fiscal Impact ----- | | | | | 0001 |